FISCAL NOTE

Bill #: SB0463 **Title:** Reduce capital gains for employee owned stock

Primary Sponsor: Black, J **Status:** Third Reading

Sponsor signature Date Chuck Swysgood, Budget Director Date

Fiscal Summary

	FY 2004 Difference	FY 2005 Difference
Expenditures:		
General Fund	$18,213	$0
Revenue:		
General Fund	$(541,917)	$(795,859)
Net Impact on General Fund Balance:	$(560,130)	$(795,859)

☐ Significant Local Gov. Impact ☐ Technical Concerns

☐ Included in the Executive Budget ☐ Significant Long-Term Impacts

☐ Dedicated Revenue Form Attached ☐ Needs to be included in HB 2

Fiscal Analysis

ASSUMPTIONS:

1. This bill allows taxpayers to make an election to receive preferential tax treatment for the sale of certain *publicly or privately* traded capital stock. The special treatment does not apply to stock rights, stock warrants, stock options, or debt securities.
2. The election pertains only to certain "corporations"; where a corporation, at the time of the first sale or exchange of stock for which the election has been made, must
   a) have been engaged in business in the state for at least three years;
   b) be headquartered in Montana (a corporation is considered to be headquartered in Montana if more than 50% of its corporate officers reside in the state);
   c) have at least 35% of its employees in the state;
   d) have at least 25 shareholders with at least three shareholders or group of shareholders who are not "related" to each other, and each of whom owns at least 10% of the capital stock of the corporation; and
   e) have at least 25 full-time employees residing within the state at all times during the previous 3 years.
3. Under this bill, an individual (or qualifying trust) can elect to have the net long-term capital gain from the sale or exchange of capital stock taxed at a preferential tax rate under either of two circumstances:
   a) the stock could have been acquired by the individual on account of employment by the corporation, or
   b) the stock could have been acquired by the individual while employed by the corporation.

In other words, any individual who purchases stock in a qualifying corporation while employed by that corporation can elect to have the proceeds from the sale of that stock treated at the preferential rate provided for in the bill.

4. Under this bill, the election also applies to the sale or exchange of stock that has been transferred by *inter vivos* gift from the individual to the individual's spouse or children, or to a trust for the benefit of the individual's spouse or children.
5. Under this bill, making the election for the sale of qualifying capital stock would allow the stock to be taxed at the flat rate of 2%; rather than at marginal rates that range from 2% to as high as 11% under current law.
6. The bill is effective on passage and approval, and applies to tax years beginning after December 31, 2002. This bill will reduce general fund revenue. The Department of Revenue has no reliable means of determining the fiscal impact of this bill. However, certain provisions of the bill, including that the corporation must have been engaged in business in the state for at least three years; must be headquartered in Montana; and must have at least 50% of its employees in the state will act to contain the fiscal impact of this bill. For example, sales of employee-owned stock by employees of the major corporations doing business in Montana, but not headquartered in the state, will not be eligible for the preferential tax treatment provided for in this bill. Based on the limitations in the bill, it is assumed that there will be an underlying annual impact from this bill reflecting the "normal" on-going capital gains from employees selling qualifying stock. These gains will total between 0.5% and 2% of total capital gains reported on individual income tax returns. The following table shows the reduction in tax liability in tax years 2003 through 2005 for these alternative percentages

Year	Total Capital Gains Reported on Tax Returns	% of Gains Receiving Preferenntial Treatment Under SB463	$ Amount of Gains Receiving Preferenntial Treatment Under SB463	Revenue Impact
2003	$499,923,000	**0.5%**	$2,499,615	**($135,479)**
2004	$734,187,000	**0.5%**	$3,670,935	**($198,965)**
2005	$830,366,000	**0.5%**	$4,151,830	**($225,029)**

Year	Total Capital Gains Reported on Tax Returns	% of Gains Receiving Preferenntial Treatment Under SB463	$ Amount of Gains Receiving Preferenntial Treatment Under SB463	Revenue Impact
2003	$499,923,000	**1%**	$4,999,230	**($270,958)**
2004	$734,187,000	**1%**	$7,341,870	**($397,929)**
2005	$830,366,000	**1%**	$8,303,660	**($450,058)**

Year	Total Capital Gains Reported on Tax Returns	% of Gains Receiving Preferenntial Treatment Under SB463	$ Amount of Gains Receiving Preferenntial Treatment Under SB463	Revenue Impact
2003	$499,923,000	**2%**	$9,998,460	**($541,917)**
2004	$734,187,000	**2%**	$14,683,740	**($795,859)**
2005	$830,366,000	**2%**	$16,607,320	**($900,117)**

The introduced version of this bill pertained only to stock that was publicly traded. The current, amended version pertains to stock that is both publicly and privately traded. The introduced version assumed that this bill reduces general fund revenue by $270,958 in fiscal year 2004 and by $397,929 in fiscal year 2005. Under the amended version, this impact is doubled to $541,917 in fiscal 2004 and $795,859 in fiscal year 2006.

7. The above fiscal impacts reflect the underlying, and on-going impacts from normal day-to-day selling of qualifying stock by employees of qualifying corporations. What they do not reflect is the extraordinary, one-time occurrences of sales of stock in companies that may have been privately held, but then decide to go public with the owners selling their shares in the company prior to retirement. In these cases, it is

possible to have qualifying sales of stock that could total, say, $100,000,000. In this particular example, there would be a one-time reduction in revenue of $5,420,000. Large impact occurrences of this nature would be sporadic and difficult to predict, but are likely to occur intermittently over the course of time.

8. The Department of Revenue will have to modify the individual income tax processing systems to accommodate the differential tax rate applied to qualifying capital gains under this bill. This will increase administrative expenses $18,213 in fiscal year 2004.

FISCAL IMPACT:	FY 2004 Difference	FY 2005 Difference
Expenditures:		
Contracted/Personal Services	$18,213	
Funding of Expenditures:		
General Fund (01)	$18,213	
Revenues:		
General Fund (01)	$(541,917)	$(795,859)
Net Impact to Fund Balance (Revenue minus Funding of Expenditures):		
General Fund (01)	$(560,130)	$(795,859)

EFFECT ON COUNTY OR OTHER LOCAL REVENUES OR EXPENDITURES:
No impact.

LONG-RANGE IMPACTS:
This bill will reduce general fund revenues in all future years by an undeterminable amount.